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# Rethinking the Nature of the Firm: The Corporation as a Governance Object

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## **Rethinking the Nature of the Firm: The Corporation as a Governance Object**

Peer Zumbansen

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**Abstract:** This Article attempts to bridge two discourses—corporate governance and contract governance. Regarding the latter, a group of scholars has recently set out to develop a more comprehensive research agenda to explore the governance dimensions of contractual relations, highlighting the potential of contract theory to develop a more encompassing theory of social and economic transactions. While a renewed interest in the contribution of economic theory for a concept of contract governance drives one dimension of this research, another part of this undertaking has been to move contract theory closer to theories of social organization. Here, these scholars emphasize the “social” or “public” nature of contracts to return to a critical reflection on the classical model of one-off, spot contracts for an exchange of goods or services. The inspiration for this enterprise comes from corporate governance debates over the last two decades, which focused on competing claims of “convergence” versus “divergence” as part of an ambitious investigation into universal standards, the “end of history,” and the underlying “varieties of capitalism.” Meanwhile, the fundamental transformation of the state, which domestically and transnationally forms the background of the growing prominence of contract as a governance tool, must be seen as the other dimension of a renewed interest in “governing contracts.” This article places the corporation at the intersection of these contentions by drawing out the promise of rereading the nexus-of-contract model of the corporation from the perspective of relational contract theory.

**Key words:** Corporation, Nature of the Firm, Contract Governance, Corporate Governance, Relational Contract, Governance

## Rethinking the Nature of the Firm: The Corporation as a Governance Object

Peer Zumbansen\*

“It is important to recognize that most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals.”<sup>1</sup>

### I. INTRODUCTION

This Article attempts to bridge two discourses—corporate governance and contract governance. Regarding the latter, a group of scholars has recently set out to develop a more comprehensive research agenda to explore the governance dimensions of contractual relations, highlighting the potential of contract theory to develop a more encompassing theory of social and economic transactions.<sup>2</sup> While a renewed interest in the contribution of economic theory for a concept of contract governance drives one dimension of this research, another part of this undertaking has been to move contract theory closer to theories of social organization. Here, these scholars emphasize the “social” or “public” nature of

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\* Professor of Law and Canada Research Chair, Osgoode Hall Law School, York University, Toronto; PZumbansen@osgoode.yorku.ca. Article presented at the Berle III Symposium, Seattle University School of Law, January 12–14, 2012, with gratitude for the invitation by Charles O’Kelley and the Berle Center and the opportunity to present these ideas and for intriguing comments from the conference participants.

This Article is part of evolving work on a theory of corporate governance in the knowledge society. First steps include the following: Peer Zumbansen, *The Next “Great Transformation”? The Double Movement in Transnational Corporate Governance and Capital Markets Regulation*, in *THE SOCIAL EMBEDDEDNESS OF TRANSNATIONAL MARKETS* (Christian Joerges & Josef Falke eds., 2011); Peer Zumbansen, *The New Embeddedness of the Corporation: Corporate Social Responsibility in the Knowledge Society*, in *THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOUR AND FINANCIAL CAPITALISM* 119 (Cynthia A. Williams & Peer Zumbansen eds., 2011). Parts of the present Article draw on a presentation at the “Contract Governance” Conference in Berlin in 2010, convened by Florian Möslin, Karl Riesenhuber and Stefan Grundmann. Thanks to Amar Bhatia, Tracey Linstead, and Aviv Pichhadze for valuable feedback, to Money Khoromi and Douglas Sarro for excellent research assistance, as well as to David Konkel and Joan Miller at the *Seattle University Law Review* for their truly outstanding and succinct editorial work on this paper.

1. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976).

2. CONTRACT GOVERNANCE (Florian Möslin et al. eds., forthcoming 2012); Florian Möslin & Karl Riesenhuber, *Contract Governance – A Research Agenda*, 5 EUR. REV. CONT. L. 248 (2009).

contracts to return to a critical reflection on the classical model of one-off, spot contracts for an exchange of goods or services.<sup>3</sup>

The inspiration for this enterprise comes from corporate governance debates over the last two decades. These debates focused on competing claims of “convergence” versus “divergence” as part of an ambitious investigation into universal standards, the “end of history,” and the underlying “varieties of capitalism.”<sup>4</sup> Meanwhile, the fundamental transformation of the state, which domestically and transnationally forms the background of the growing prominence of contract as a governance tool, must be seen as the other dimension of a renewed interest in “governing contracts.”<sup>5</sup>

Today, half a decade after a long and expanded debate among corporate lawyers and political economists over the convergence or divergence of corporate governance systems, scholars and courts alike have moved on to address the pressing regulatory challenges in this field,<sup>6</sup> the contours of which are now just as blurred as the proverbial “nature” of the business enterprise itself.<sup>7</sup> This context provides an excellent opportunity to bring together the “internal” and “external” regulatory perspectives on the corporation. On the “inside,” there is a continuing struggle between contractual and organizational depictions of the nature of the firm, while on the “outside,” we see a continuing transformation of a regulatory framework that is increasingly disembedded from the state. An approximation of both perspectives allows us to rethink the nature of the corporation as a subject and an object of governance; the concept of contract must, however, be expanded in order to contribute to, but not alone shoulder, an adequate conceptualization of the complex architecture of the modern corporation.<sup>8</sup> Contract, which cannot be studied in

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3. See David Campbell, *Reflexivity and Welfarism in the Modern Law of Contract*, 20 OXFORD J. LEGAL STUD. 477 (2000); John P. Esser, *Institutionalizing Industry: The Changing Forms for Contract*, 21 LAW & SOC. INQUIRY 593 (1996).

4. See VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (Peter A. Hall & David Soskice eds., 2001) [hereinafter VARIETIES OF CAPITALISM]; Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, in CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 128–58 (Jeffrey Gordon & Mark Roe eds., 2004).

5. See generally HUGH COLLINS, *REGULATING CONTRACTS* (1999); PETER VINCENT-JONES, *THE NEW PUBLIC CONTRACTING: REGULATION, RESPONSIVENESS, RELATIONALITY* (2006); see also Peer Zumbansen, *The Law of Society: Governance Through Contract*, 14 IND. J. GLOBAL LEGAL. STUD. 191 (2007).

6. See, e.g., Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL’Y REV. 1 (2008).

7. Michael P. Vandenbergh, *The New Walmart Effect: The Role of Private Contracting in Global Governance*, 54 UCLA L. REV. 913 (2007).

8. While this Article will sketch the historical and theoretical background and suggest the outlines of a recontractualized concept of the corporation, a future paper will focus more specifically

isolation, occurs within the intersecting modes of governance and, as a result, provides a crucial element for building a new interdisciplinary theory of governance.

After a cursory historical sketch of the trajectory of corporate law theory in Part II, Part III offers contextual evidence for the increased interest among governance and regulation scholars in the area of corporate law. Against this background, Part IV presents a more detailed discussion and critique of contractual governance in order to challenge the otherwise oversimplifying appropriation of contract to explain complex power relations within and beyond the corporation. Part V considers the implications and challenges of the interdisciplinary theoretical analysis of corporations in the modern context. Part VI briefly concludes.

## II. STUDYING THE CORPORATION

Beginning a series of reflections on the nature of the firm today would require a particular combination of eruditeness and irony that prompts a more collective, discursive effort than a singular scholarly undertaking. With our deep scepticism of any attempt to conclusively delineate and re-craft a comprehensive theory, each and every element of this theory remains exposed to further contestation and deconstruction. Referring to the corporation as an object of study and investigation through the lenses of theories of the firm, corporate governance, or contract governance opens up—at best—a vista of a historical and intellectual universe that is in every respect overwhelming. And yet, we are drawn to the corporation, to its beginnings<sup>9</sup> and its ends,<sup>10</sup> investigating

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on the question of the board's fiduciary duties. It will suggest that an approximation of contract theory and corporate governance, with relevant regard to securities regulation, promises insights into the long-standing challenges that characterize the corporation as a contractual organization. A second future paper will further elaborate the contention made here that stakeholder interests can be advanced by reformulating the corporate contract—arguably establishing a principal-agent relationship between shareholders and management—as a public contract. In taking issue with two recent Canadian Supreme Court rulings involving large-scale corporate change of control transactions, *Peoples Dep't Stores, Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 (Can.) and *BCE, Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560 (Can.), the follow-up paper will explore the (partially lost) opportunity of crafting a more adequate theory of the firm by moving beyond the Court's interest in "interests" and its formula of the "good corporate citizen." Centrally, that paper will draw on relational contract theory and legal pluralism on the one hand and on "social norms" and evolutionary theory on the other to argue for a systemic approach to corporate governance, allowing us to take a fresh look at directors' duties and corporate social responsibility.

9. *See, e.g.*, WALTHER RATHENAU, *VOM AKTIENWESEN* [OF THE NATURE OF STOCK CORPORATIONS] 11 (1918):

Through its path from the family enterprise and association to the large corporation there has occurred a substitution of the foundation of our business associations, their organs and forms of governance and administration; but neither science, legislature nor judiciary have taken notice of this inner morphing of the grounds of being and of the forms of impact; alone a series of ever recurring conflicts, taken as contingent or arbitrary, have pen-

them as complex relationships between individual and collective instantiations of power,<sup>11</sup> as intricate spheres of organizational design,<sup>12</sup> as carriers of “public purpose,”<sup>13</sup> as sources of knowledge production and transformation,<sup>14</sup> as demarcations of social spheres and spaces,<sup>15</sup> and as illustrations of the tension between markets and hierarchies<sup>16</sup> or between different “stakeholders.”<sup>17</sup> Seen from this vista, corporations offer opportunities to study governance structures, whether or not we still think they can be demarcated along the boundaries between an “inside” and an “outside.”<sup>18</sup>

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etrated public opinion . . . . The administration of a large corporation exceeds—as concerns scope, personnel structure and impetuous shift of tasks—the government of a small state today or that of a large one of one hundred years ago. I would not know of a time nor a place on earth, including America, where year in, year out with the same velocity, security and responsibility a similar daily stock of executionary and administrative work of constructive nature would have been accomplished as is the case in the governing echelons of our large corporations.

*Id.* (Peer Zumbansen trans.). *But see* ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 309 (Transaction Publishers 1991) (1932) (“[I]t involves a concentration of power in the economic field comparable to the concentration of religious power in the mediaeval church or of political power in the national state.”).

10. *See* CHRISTOPHER D. STONE, *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* (1975); *see also* Dalia Tsuk-Mitchell, *The End of Corporate Law*, 44 WAKE FOREST L. REV. 703, 729 (2009) (“Having helped to eradicate any meaningful force out of corporate law, all that the Delaware courts have left to elaborate at the turn of the twenty-first century are ideals they are unwilling to enforce.”).

11. *See* ADOLF A. BERLE, JR., *THE 20TH CENTURY CAPITALIST REVOLUTION* 15 (1954).

12. *See, e.g.,* Eric Orts, *The Future of Enterprise Organization*, 96 MICH. L. REV. 1947 (1998).

13. Charlotte Villiers, *Corporate Law, Corporate Power and Corporate Social Responsibility*, in *PERSPECTIVES ON CORPORATE SOCIAL RESPONSIBILITY* 85 (Nina Boeger, Rachel Murray & Charlotte Villiers eds., 2008); Peter Cornelius & Bruce Kogut, *Creating the Responsible Firm: In Search for a New Corporate Governance Paradigm*, 4 GERMAN L.J. 45 (2003); Simon Deakin, *Squaring the Circle? Shareholder Value and Corporate Social Responsibility in the UK*, 70 GEO. WASH. L. REV. 976 (2002).

14. Cristiano Antonelli, *The Evolution of the Industrial Organisation of the Production of Knowledge*, 23 CAMBRIDGE J. ECON. 243 (1999); Mary O’Sullivan, *The Innovative Enterprise and Corporate Governance*, 24 CAMBRIDGE J. ECON. 393 (2000).

15. Marina Welker, Damani J. Partridge & Rebecca Hardin, *Corporate Lives: New Perspectives on the Social Life of the Corporate Form: An Introduction to Supplement 3*, 52 CURRENT ANTHROPOLOGY S3 (2011). “[U]nderstanding corporations as social forms, actors embedded in complex relations, and entities that produce and undergo transformation, with all the friction that entails.” *Id.* at S4 (citation omitted).

16. *See* Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LIT. 1537 (1981). For a critique, *see* GUNTHER TEUBNER, *LAW AS AN AUTOPOIETIC SYSTEM* 127–31 (Anne Bankowska & Ruth Adler trans., 1993).

17. *See* Simon Deakin, *Workers, Finance and Democracy*, in *THE FUTURE OF LABOUR LAW: LIBER AMICORUM BOB HEPPLE QC* 79 (Catherine Barnard et al. eds., 2003); Sanford M. Jacoby, *Labor and Finance in the United States*, in *THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOUR, AND FINANCE CAPITALISM* 277 (Cynthia A. Williams & Peer Zumbansen eds., 2011) [hereinafter *THE EMBEDDED FIRM*].

18. Rejecting the boundary, *see* Jensen & Meckling, *supra* note 1, at 311, and Gillian K. Hadfield, *Legal Infrastructure and the New Economy*, 8 J.L. & POL’Y FOR INFO. SOC’Y 1, 8 (2011).

The following observations are inspired by the evolution of the corporation as a focus of investigation among legal scholars, economists, sociologists, political scientists, historians, and anthropologists demonstrating that the corporation, as an academic subject, has long ceased to belong to legal scholars alone. It is perhaps only a little less trite to observe that the same is true for the field of corporate law itself. Theory and practice of the field suggest that we must approach and understand corporate law not only as a point of conflict between allegedly diametrically opposed “theories of the firm” or between shareholder and stakeholder conceptions, but also as a vibrant, multilayered regulatory regime. A regime characterized by overlapping, intervening, and conditioning authorities, nontraditional rule-makers, mixed norms, and new, not exclusively state-based, enforcement and compliance mechanisms.

The present Article, then, is informed by an interest in corporate governance, broadly understood. Such studies today are of an unavoidably interdisciplinary nature, given the multifaceted nature of the corporation and the resulting concert of interpreting and analyzing disciplines that rally around the subject. At the same time, corporate lawyers must confront a mix of relatively concrete challenges that arise from the governance and operation of the corporation and larger considerations regarding the societal status, nature, or responsibility of the corporation. The answers to these questions have, over time, contributed to a considerable differentiation and deepening of the field, making the corporation an *objet trouvé* of a very particular kind. In other words, the corporation has long been in the center of research that analyzes the governance framework and architecture of the corporation, the nature and pressures of different interests in and around the corporation, as well as its larger place and role in society.

In more than one way, the current “open-mindedness” of corporate law as an intellectual and interdisciplinary undertaking bears some resemblance to an earlier period in history roughly a century ago. At that time, legal scholars’ work on the corporation displayed a heightened degree of sensitivity to the interplay between the internal governance dimensions of the corporation and the evolving normative infrastructure of corporate or company law in relation to a fast-unfolding market society.<sup>19</sup>

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(“Fast-paced, global, niche-driven, and increasingly network- rather than firm-based, the economy today is poorly served by legal markets and institutions developed to meet the demands generated by an economy based on standardized mass-market manufacturing, predominantly domestic, markets, and production organized within rather than across firm boundaries.”).

19. See ERNST FREUND, THE LEGAL NATURE OF CORPORATIONS (1897); FRANZ KLEIN, DIE NEUEREN ENTWICKLUNGEN IN VERFASSUNG UND RECHT DER AKTIENGESELLSCHAFT [NEW DEVELOPMENTS OF THE CONSTITUTION AND LAW OF THE STOCK CORPORATION] (1904); FRITZ



Both legal scholars and economists undertook parallel and increasingly discursive and collaborative endeavors, fuelling research on the corporation and its place in a politically and economically volatile environment.<sup>20</sup> This path of scholarship reignited in intensified fashion in the 1970s and '80s.

Meanwhile, and in contrast to much debate around the growing role of corporations on the national and global scale<sup>21</sup> from political, historical, and sociological perspectives, the "law and economics" movement spread like "prairie fire" through corporate law academia and law schools in general.<sup>22</sup> Next came a period of greater interest among corporate lawyers in market structures, this time allowing for a closer exchange between theoretical models and "real world" evidence from vibrant and integrating markets.<sup>23</sup> In the shadow of the experience of the takeover-frenzied 1980s,<sup>24</sup> the "Roaring Nineties,"<sup>25</sup> and the burgeoning exuberance of the "new economy" before its fall,<sup>26</sup> corporate governance as a field for lawyers, economists, and comparative political economists emerged as a truly global research and policy area.<sup>27</sup> At a time when starting associates in New York, Frankfurt, or Paris were paid premium salaries to work on the mergers and acquisitions boom,<sup>28</sup> legal scholars

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NAPHTALI, WIRTSCHAFTSDEMOKRATIE: IHR WESEN, WEG UND ZIEL [ECONOMIC DEMOCRACY: ITS NATURE, PATH AND GOAL] (1928).

20. See BERLE & MEANS, *supra* note 9; ROBERT C. CLARK, *CORPORATE LAW* (1986); MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994); Erich Schanze, *Potential and Limits of Economic Analysis: The Constitution of the Firm*, in *CONTRACT AND ORGANISATION: LEGAL ANALYSIS IN THE LIGHT OF ECONOMIC AND SOCIAL THEORY* 204 (Terence Daintith & Gunther Teubner eds., 1986) [hereinafter *CONTRACT AND ORGANISATION*]; THORSTEIN VEBLEN, *THE THEORY OF BUSINESS ENTERPRISE* (1904); Arman A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 52 AM. ECON. R. 777 (1972); Jensen & Meckling, *supra* note 1.

21. Then: JOHN KENNETH GALBRAITH, *THE NEW INDUSTRIAL STATE* (1967); now: NAOMI KLEIN, *THE SHOCK DOCTRINE: THE RISE OF DISASTER CAPITALISM* (2007).

22. See Brian R. Cheffins, *The Trajectory of (Corporate) Law Scholarship*, 63 CAMBRIDGE L.J. 456 (2004).

23. See, e.g., Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161 (1992).

24. See Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, 9 YALE J. ON REG. 119 (1992).

25. See JOSEPH STIGLITZ, *THE ROARING NINETIES: SEEDS OF DESTRUCTION* (2003).

26. See DOUG HENWOOD, *AFTER THE NEW ECONOMY: THE BINGE . . . AND THE HANGOVER THAT WON'T GO AWAY* (2003); Ugo Pagano & Maria Alessandra Rossi, *The Crash of the Knowledge Economy*, 33 CAMBRIDGE J. ECON. 665 (2009).

27. For a brilliant overview and analysis of the field, see John W. Cioffi, *State of the Art: A Review Essay on Comparative Corporate Governance: The State of the Art and Emerging Research*, 48 AM. J. COMP. L. 501 (2000).

28. But see the situation today. Roben Farzad, *Law Firms Trim Their Ranks to Boost Profits*, BLOOMBERG BUSINESSWEEK (Apr. 28, 2011), [http://www.businessweek.com/magazine/content/11\\_19/b4227016790130.htm](http://www.businessweek.com/magazine/content/11_19/b4227016790130.htm).

were touring the global conference circuit to propagate<sup>29</sup> or to debate, as the case might have been, the triumph of converging corporate governance systems.<sup>30</sup> The ensuing two decades of corporate governance research were particularly vibrant, as legal scholars, economists, sociologists, and political economists unpacked the distinctions in the historical and socio-economic-political trajectories of different corporate law regimes.<sup>31</sup> Then came Enron.<sup>32</sup>

This collapse confronted corporate governance research with a freshly amplified “public” interest in the corporation and its regulation not least because accounting practices, interlocked corporate entities, and executive compensation had become widely visible newspaper headlines. Corporate governance research overall proliferated. Inspired by comparative legal analysis<sup>33</sup> and by interdisciplinary research on the “varieties of capitalism,” a growing number of corporate governance scholars have routinely been collaborating from their home bases in law, management studies, corporate social responsibility (CSR), or organizational psychology.<sup>34</sup> These scholars regularly second-guess the extremely influential assertions put forward by a group of scholars who had relied on empiri-

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29. See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001); see also Henry Hansmann, *How Close is the End of History?*, 31 J. CORP. L. 745 (2006).

30. For insightful assessments, see Douglas M. Branson, *The Very Uncertain Prospect of “Global” Convergence in Corporate Governance*, 34 CORNELL INT’L L.J. 321 (2001); Ronald Dore, William Lazonick & Mary O’Sullivan, *Varieties of Capitalism in the Twentieth Century*, 15 OXFORD REV. ECON. POL’Y 102 (1999). And with further differentiation, see Ruth V. Aguilera, Kurt A. Desender & Luiz Ricardo Kabbach de Castro, *A Bundle Perspective to Comparative Corporate Governance*, in SAGE HANDBOOK OF CORPORATE GOVERNANCE 379, 391 (Thomas Clarke & Douglas Branson eds., 2011).

31. See JOHN W. CIOFFI, PUBLIC LAW AND PRIVATE POWER: CORPORATE GOVERNANCE REFORM IN THE UNITED STATES AND GERMANY IN AN AGE OF FINANCE CAPITALISM (2010); David Soskice, *Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980’s and 1990’s*, in CONTINUITY AND CHANGE IN CONTEMPORARY CAPITALISM 101 (Herbert Kitschelt et al. eds., 1999); Sigurt Vitols, *Varieties of Corporate Governance: Comparing Germany and the UK*, in VARIETIES OF CAPITALISM, *supra* note 4, at 337; John W. Cioffi, *Governing Globalization? The State, Law, and Structural Change in Corporate Governance*, 27 J.L. & SOC’Y 572 (2000); William Lazonick, *Varieties of Capitalism and Innovative Enterprise*, 24 COMP. SOC. RES. 21 (2007).

32. See William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002); Simon Deakin & Suzanne J. Konzelmann, *Learning from Enron*, 12 CORP. GOVERNANCE: AN INT’L REV. 134 (2004).

33. For a selection of the positions, see CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE, *supra* note 4, at 128–58; see also Klaus Jürgen Hopt, *Comparative Company Law*, in THE OXFORD HANDBOOK OF COMPARATIVE LAW 1161 (Mathias Reimann & Reinhard Zimmermann eds., 2006); David C. Donald, *Approaching Comparative Company Law*, 14 FORDHAM J. CORP. & FIN. L. 83 (2008).

34. A fitting illustration is given in Ruth Aguilera, Deborah Rupp, Cynthia A. Williams & Jyoti Ganapathi, *Putting the S Back in Corporate Social Responsibility: A Multi-Level Theory of Social Change in Organizations*, 32 ACAD. MGMT. REV. 836 (2004).

cal studies to ascertain a strong correlation between legal origins, ownership structures, and shareholder rights.<sup>35</sup> Scholars in Europe and in North America challenged these findings on various fronts and contributed to an altogether much more differentiated picture of corporate governance regulation.<sup>36</sup>

Concurrently, scholars began studying the corporation and its regulatory infrastructure from yet another perspective. Their primary interest is in the corporation as a hybrid entity, caught between being a *subject* and an *object* of rule-making.<sup>37</sup> This ambivalent nature of the corporation lends itself perfectly to what has, in our day, become a multipronged investigation into the evolving nature of the corporation, as it appears on both sides of its artificially constructed boundaries.<sup>38</sup> On the “inside,” scholars have worked hard to lay bare what makes the corporation “tick” so that we may best understand, shape, and influence the roles played by various members of the corporate organization.<sup>39</sup> On the corporation’s “outside,” the picture is just as perplexing: in light of the indisputable fact that the corporation remains the dominant force in a globally integrated economy,<sup>40</sup> scholars have increasingly directed their attention at the complex regulatory and normative landscape in which the corpora-

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35. See Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. ECON. LIT. 285 (2008); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

36. Ruth V. Aguilera & Cynthia A. Williams, “*Law and Finance*”: *Inaccurate, Incomplete, and Important*, 2009 BYU L. REV. 1413; Mathias M. Siems & Simon Deakin, *Comparative Law and Finance: Past, Present and Future Research*, 166 J. INSTITUTIONAL & THEORETICAL ECON. 120 (2010); Holger Spamann, *Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law*, 2009 BYU L. REV. 1813.

37. See, e.g., Michael Power, *Constructing the Responsible Organization: Accounting and Environmental Representation*, in ENVIRONMENTAL LAW AND ECOLOGICAL RESPONSIBILITY: THE CONCEPT AND PRACTICE OF ECOLOGICAL SELF-ORGANIZATION 369 (Gunther Teubner et al. eds., 1994); TEUBNER, *supra* note 16, at 123–58.

38. See John Dewey, *The Historical Background of Corporate Legal Personality*, 35 YALE L.J. 655 (1926).

39. See, e.g., MICHEL CROZIER, L’ENTREPRISE A L’ECOUTE: APPRENDRE LE MANAGEMENT POST-INDUSTRIEL [THE ENTERPRISE UNDER SCRUTINY: LEARNING POST-INDUSTRIAL MANAGEMENT] (Seuil 1994) (1989); JAMES E. POST, LEE E. PRESTON & SYBILLE SACHS, REDEFINING THE CORPORATION: STAKEHOLDER MANAGEMENT AND ORGANIZATIONAL WEALTH (2002); JOHN ROBERTS, THE MODERN FIRM: ORGANIZATIONAL DESIGN FOR PERFORMANCE AND GROWTH (2004); Marjolijn S. Dijksterhuis, Frans A. J. Van den Bosch & Henk W. Volberda, *Where Do New Organizational Forms Come From? Management Logics as a Source of Coevolution*, 10 ORG. SCI. 569 (1999); Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233 (2002).

40. See Detlev F. Vagts, *The Multinational Enterprise: A New Challenge for Transnational Law*, 83 HARV. L. REV. 739 (1970).

tion operates. These studies<sup>41</sup> coalesce to sketch a detailed map of the interplay between the “hard” and “soft,” “public” and “private” norms that shape corporate activities.<sup>42</sup>

On the following pages, we gaze inward toward the “inner” life of the corporation. The goal of this reorientation is to take a closer look at the interaction between two theoretical constructs in the assessment of the corporation. One—corporate governance—is merely another framework through which scholars have been studying the organizational design and power structure of the modern business corporation for some time.<sup>43</sup> The other is concerned with contract governance and aims at approximating an already highly differentiated body of work on and around contract law to the research done under the corporate governance umbrella. The hope is that a parallel view and border-crossing engagement with both approaches can unlock some of the deadlocks that are inherent to each. In order to more fully understand the upsides (and downsides) of contract thinking regarding the corporation, it will be helpful to contextualize the present interest in contract governance against the background of a fundamental transformation of the regulatory state, which gives rise to unfolding processes of decentralization, privatization, and to institutional and normative pluralism.<sup>44</sup> These processes raise significant questions with regard to law as a tool of societal governance, and it is to these questions that the article now turns.

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41. See, e.g., SUMMARY REPORT: EXPERT MEETING ON CORPORATE LAW AND HUMAN RIGHTS: OPPORTUNITIES AND CHALLENGES OF USING CORPORATE LAW TO ENCOURAGE CORPORATIONS TO RESPECT HUMAN RIGHTS, SPECIAL REPRESENTATIVE OF THE SECRETARY GENERAL [SRSG] CORPORATE LAW TOOLS PROJECT (2010), available at <http://www.valoresociale.it/detail.asp?c=1&p=0&id=316>; David Weissbrodt & Muria Kruger, *Human Rights Responsibilities of Business as Non-State Actors*, in NON-STATE ACTORS AND HUMAN RIGHTS 315 (Philip Alston ed., 2005); David Kinley & Junko Tadaki, *From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law*, 44 VA. J. INT'L L. 931 (2004); Gunther Teubner, *Self-Constitutionalizing TNCs? On the Linkage of “Private” and “Public” Corporate Codes of Conduct*, 18 IND. J. GLOBAL LEGAL STUD. 617 (2011).

42. See Peer Zumbansen, *Neither ‘Public’ nor ‘Private,’ ‘National’ nor ‘International’: Transnational Corporate Governance from a Legal Pluralist Perspective*, 38 J.L. & SOC'Y 50 (2011).

43. See Mark J. Roe, *Comparative Corporate Governance*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 339–46 (Peter Newman ed., 1998) [hereinafter THE NEW PALGRAVE DICTIONARY].

44. For a concise analysis, see Colin Scott, *Regulation in the Age of Governance: The Rise of the Post Regulatory State*, in THE POLITICS OF REGULATION: INSTITUTIONS AND REGULATORY REFORMS FOR THE AGE OF GOVERNANCE 145–74 (Jacint Jordana & David Levi-Faur eds., 2004).

### III. THE LAWYER'S MINDSET AND THE NEW TWIST IN LAW AND ECONOMICS

Oliver Wendell Holmes, Jr. notes toward the end of his landmark essay, *The Path of the Law*, that “[w]e cannot all be Descartes or Kant, but we all want happiness.”<sup>45</sup> As students of this text once knew, he continues to remark:

And happiness, I am sure from having known many successful men, cannot be won simply by being counsel for great corporations and having an income of fifty thousand dollars. An intellect great enough to win the prize needs other food beside success. The remoter and more general aspects of the law are those which give it universal interest. It is through them that you not only become a great master in your calling, but connect your subject with the universe and catch an echo of the infinite, a glimpse of its unfathomable process, a hint of the universal law.<sup>46</sup>

There is much in these lines to ponder. Holmes’s essay, throughout, reads—and was meant—as a wholehearted assault on dearly held beliefs regarding the objective nature of abstract legal principles, the separation of law and morality, and the construction of legal rules in following the command of logic. Heralded—by none other than one of the founding fathers of law and economics and one of the great, innovative, and continuously surprising legal minds of our day<sup>47</sup>—as a prophecy coming true,<sup>48</sup> Holmes’s essay placed a great number of the core treats of the coming legal evolution before his readers’ eyes—over 110 years ago.

Where Holmes pointed to the rising significance of science and economics for the theory and practice of law,<sup>49</sup> the ensuing legal evolu-

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45. Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 478 (1897) [hereinafter Holmes, *The Path of the Law*]; see also OLIVER WENDELL HOLMES, *On Receiving the Degree of Doctor of Laws, Yale University Commencement (June 30, 1886)*, in COLLECTED LEGAL PAPERS 33 (1920) (“The power of honor to bind men’s lives is not less now than it was in the Middle Ages. Now as then it is the breath of our nostrils; it is that for which we live, for which, if need be, we are willing to die. It is that which makes the man whose gift is the power to gain riches sacrifice health and even life to the pursuit. It is that which makes the scholar feel that he cannot afford to be rich.”).

46. Holmes, *The Path of the Law*, *supra* note 45.

47. “And suppose no corporation had ever been punished for violating customary international law. There is always a first time for litigation to enforce a norm; there has to be.” *Flomo v. Firestone Nat’l Rubber Co.*, 643 F.3d 1013, 1017 (7th Cir. 2011).

48. Richard A. Posner, *The Path Away from the Law*, 110 HARV. L. REV. 1039, 1043 (1997).

49. See OLIVER WENDELL HOLMES, *Law in Science and Science in Law*, in COLLECTED LEGAL PAPERS, *supra* note 45, at 210:

A hundred years ago men explained any part of the universe by showing its fitness for certain ends, and demonstrating what they conceived to be its final cause according to a providential scheme. In our less theological and more scientific day, we explain an object

tion proved him right. What sets the present apart from the past, however, is that precisely this transformation of legal science into its present-day conundrinal mixture of legal theory and philosophy, regulatory theory or “governance,”<sup>50</sup> and economic theory<sup>51</sup> not only goes beyond the initially sketched parameters but also fundamentally undermines a view that would conceive of law as of a field and its neighbor disciplines.<sup>52</sup> “The centre cannot hold”<sup>53</sup>—law’s autonomous status within a densely structured context of social order theories is undermined, already by Holmes himself, by exposing it to a complex set of questions touching on the nature, function, and form of law. These questions eventually challenge the boundaries between law and non-law. And this precisely proved to be the aftermath and legacy of Holmes’s and his colleagues’ anti-formalist attack: a powerful engagement with the assumptions, theories, and policies of legal argument.<sup>54</sup>

This context provides promising, if not intimidating, entry points for law’s engagement with itself and all that it might, and might not, be. Lawyers like Holmes were well-aware of the vulnerability of the edifice of norms, court rooms, and law school curricula long before the advent of globalization, the much lamented exhaustion of the state’s regulatory capacities,<sup>55</sup> and the legal system’s increased generation of “regulatory laws,” which due to their complex nature raise particular compliance challenges.<sup>56</sup> With this in mind, we must remain aware of the continuous-

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by tracing the order and process of its growth and development from a starting point assumed as given.

50. Arguably, the new paradigm in administrative sciences. See, e.g., PHILIPPE MOREAU DEFARGES, *LA GOUVERNANCE* [GOVERNANCE] (2008); Claudio Franzius, *Governance und Regelungsstrukturen*, 97 VERWALTUNGSARCHIV [ADMINISTRATIVE ARCHIVE] 186 (2006); Oliver E. Williamson, *The Economics of Governance*, 95 AM. ECON. REV. 1 (2005). For a paradigm adopted on both the national and the global level, see THOMAS HALE & DAVID HELD, *HANDBOOK OF TRANSNATIONAL GOVERNANCE* (2011); HELMUT WILLKE, *SMART GOVERNANCE: GOVERNING THE GLOBAL KNOWLEDGE SOCIETY* (2007); Fleur E. Johns, *Global Governance: An Heretical History Play*, 4 GLOBAL JURIST ADVANCES Art. 3 (2004), available at <http://ssrn.com/abstract=603232>; and Peer Zumbansen, *Governance: An Interdisciplinary Perspective*, in *THE OXFORD HANDBOOK ON GOVERNANCE* (David Levi-Faur ed., 2012).

51. See John Oberdiek, *Philosophical Issues in Tort Law*, 3 PHILOSOPHY COMPASS 734 (2008); Oliver Williamson, *The Lens of Contract: Private Ordering*, 92 AM. ECON. REV. 438 (2002).

52. See, e.g., DIETER GRIMM, *RECHTSWISSENSCHAFT UND NACHBARWISSENSCHAFTEN* [LAW AND NEIGHBORING SCIENCES] (1976).

53. William Butler Yeats, *The Second Coming* (1920).

54. See DUNCAN KENNEDY, *THE RISE AND FALL OF CLASSICAL LEGAL THOUGHT* (1975); Felix Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935); Roscoe Pound, *The Call for a “Realist” Jurisprudence*, 44 HARV. L. REV. 697 (1931); Roscoe Pound, *Law in Books and Law in Action*, 44 AM. L. REV. 12 (1910).

55. See KARL LLEWELLYN, *THE BRAMBLE BUSH: ON OUR LAW AND ITS STUDY* (Oceana Publ’ns 1950) (1930).

56. See Kristin E. Hickman & Claire A. Hill, *Concepts, Categories, and Compliance in the Regulatory State*, 94 MINN. L. REV. 1151, 1159–74 (2010). “[R]egulatory laws tend to differ from

ly mounted challenges of law's empire, as they are promulgated by economists,<sup>57</sup> sociologists,<sup>58</sup> geographers,<sup>59</sup> or anthropologists,<sup>60</sup> just to name a few of the disciplines with a keen interest in law as a governance tool.<sup>61</sup> To reflect on the origins of interdisciplinary thinking of and around law, as it pertains to the corporation, is especially crucial at a time when scientific advances propel a rapidly growing knowledge base concerning just about anything connected to legal reasoning. This knowledge environment creates the potential for the ubiquitous excitement about a new "Law and . . . ,"<sup>62</sup> having an almost overwhelming effect on us regarding an awareness and appreciation of much older engagements with law's interdisciplinary foundations.

The current interest in law's psychological<sup>63</sup> and behavioral economic<sup>64</sup> dimensions gives the indisputable triumph of law and economics over other law and society movements yet another twist. This triumph implicates important consequences for our understanding of the embeddedness of law in a rich context of theoretical and empirical studies of human—individual and collective<sup>65</sup>—and institutional behavior.<sup>66</sup> The dialogue between economics, sociology,<sup>67</sup> and evolutionary theory<sup>68</sup> has

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other types of law in the complexity of both their subject matter and the programs they establish." *Id.* at 1174.

57. See AVINASH K. DIXIT, *LAWLESSNESS AND ECONOMICS: ALTERNATIVE MODES OF GOVERNANCE* (2004).

58. See Saskia Sassen, *The State and Economic Globalization: Any Implications for International Law?*, 1 U. CHI. J. INT'L L. 109 (2000).

59. See David Harvey, *The Sociological and Geographical Imaginations*, 18 INT'L J. POL., CULTURE & SOC'Y 211 (2005).

60. See Sally Engle Merry, *Measuring the World: Indicators, Human Rights, and Global Governance*, 52 CURRENT ANTHROPOLOGY S83 (2011).

61. For a discussion, see Annelise Riles, *A New Agenda for the Cultural Study of Law: Taking on the Technicalities*, 53 BUFF. L. REV. 973 (2005); see also Peer Zumbansen, *Governance: An Interdisciplinary Perspective*, in THE OXFORD HANDBOOK ON GOVERNANCE, *supra* note 50.

62. See, e.g., the scholars and related specialized programs ranging from Law and Psychology, <http://www.law.stanford.edu/program/degrees/joint/psychology/>; Law and Geography, <http://www.sfu.ca/~blomley/research.html>; Law and Biology, [http://digitalcommons.law.yale.edu/fss\\_papers/2216](http://digitalcommons.law.yale.edu/fss_papers/2216); Law and Ethics, [http://www.trinity.utoronto.ca/Current\\_Students/esl.htm](http://www.trinity.utoronto.ca/Current_Students/esl.htm); to Law and Science, [http://web.mit.edu/~ssilbey/www/pdf/Silbey\\_I\\_fnl.pdf](http://web.mit.edu/~ssilbey/www/pdf/Silbey_I_fnl.pdf).

63. See, e.g., the brilliant work by Ruth Aguilera and others, *supra* notes 34 and 36.

64. See BEHAVIOURAL LAW & ECONOMICS (Cass R. Sunstein ed., 2000).

65. See LAW AND HAPPINESS (Eric A. Posner & Cass R. Sunstein eds., 2010).

66. See Dani Rodrik, Arvind Subramanian & Francesco Trebbi, *Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development*, 9 J. ECON. GROWTH 131 (2004); see also DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).

67. See, e.g., DIRK BAECKER, WIRTSCHAFTSSOZIOLOGIE [ECONOMIC SOCIOLOGY] (2006); Victor Nee & Richard Swedberg, *Economic Sociology and New Institutional Economics*, in HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 789 (Claude Ménard & Mary Shirley eds., 2005).

68. See RICHARD R. NELSON & SIDNEY G. WINTER, AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE (1985); Peer Zumbansen & Galf-Peter Calliess, *Law, Economics, and Evolu-*

considerable roots, giving rise to a number of very promising research avenues, altogether fostering a more expansive and interdisciplinary interest in norm-creation<sup>69</sup> and societal ordering.<sup>70</sup> Building on, but going beyond the Legal Realists' attack of the impenetrable judicial mindset,<sup>71</sup> law and psychology scholars and behavioral economists have more recently taken toward a better understanding of the motivational forces behind legal and wider social decision-making.<sup>72</sup>

What insights should we as corporate law scholars, and as legal scholars more generally, begin to draw from these suggestions? In order to begin to unpack the interdisciplinary promise for a better understanding of law today, the picture needs to be more accentuated. Lawyers in different areas such as, but not limited to, criminal law, tort law, constitutional law, and international law<sup>73</sup> have long been addressing structures and effects of (for example) collective human behavior. At the basis of such engagement has been the recognition that the attribution of different legally scrutinizable forms of guilt, responsibility, accountability, or—in international law—authority<sup>74</sup> requires a particular legal theoretical effort to address incomplete or inchoate chains of causation. Early on, lawyers recognized that in order to make sense of the intertwined nature of individual and collective behavior either in extreme circumstances<sup>75</sup> or in organizational corporate contexts,<sup>76</sup> they would have to expand traditional legal categories.

Additionally, the work in organizational psychology and behavioral economics, which scholars have brought to bear on corporate governance with increasing intensity,<sup>77</sup> has a number of further applications that de-

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*tionary Theory: State of the Art and Interdisciplinary Perspectives*, LAW, ECONOMICS AND EVOLUTIONARY THEORY 1 (Peer Zumbansen & Galf-Peter Calliess eds., 2011).

69. See NORMS AND THE LAW (John N. Drobak ed., 2006); Richard A. Posner, *Social Norms, Social Meaning, and Economic Analysis of Law: A Comment*, 27 J. LEGAL STUD. 553 (1998); Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903 (1996).

70. See Elinor Ostrom, *Challenges and Growth: The Development of the Interdisciplinary Field of Institutional Analysis*, 3 J. INSTITUTIONAL ECON. 239 (2007).

71. See Roscoe Pound, *Mechanical Jurisprudence*, 8 COLUM. L. REV. 605 (1908).

72. E.g., RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE. IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (2008).

73. E.g., Balakrishnan Rajagopal, *International Law and Social Movements: Challenges of Theorizing Resistance*, 41 COLUM. J. TRANSNAT'L L. 397 (2003).

74. See Christoph Schreuer, *The Waning of the Sovereign State: Towards a New Paradigm for International Law?*, 4 EUR. J. INT'L L. 447 (1993).

75. See CHRISTOPHER R. BROWNING, *ORDINARY MEN: RESERVE POLICE BATTALION 101 AND THE FINAL SOLUTION IN POLAND* (1992).

76. See *Canadian Dredge & Dock Co. Ltd. v. The Queen*, [1985] 1 S.C.R. 662 (Can.).

77. See, e.g., CHESTER BARNARD, *THE FUNCTIONS OF THE EXECUTIVE* (1938); CHESTER BARNARD, *MODELS OF BOUNDED RATIONALITY: BEHAVIORAL ECONOMICS AND BUSINESS ORGANIZATION* (1982); THOMAS DONALDSON, *CORPORATIONS AND MORALITY* (1982); HERBERT SIMON, *ADMINISTRATIVE BEHAVIOR* (1947); Aguilera, Rupp, Williams & Ganapathi, *supra* note 34;



serve our attention. The applications become apparent when we return to the earlier projects undertaken primarily by law and society scholars with the aim of rendering a more complete picture of the embeddedness of legal regulation in heterogeneous normative and institutional settings. Groundbreaking work in that regard was carried out, for example, in the area of contract law.<sup>78</sup> Lawyers,<sup>79</sup> legal pluralists,<sup>80</sup> and sociologists<sup>81</sup> were among those who pointed to the myriad forms in which informal norms governed behavior in far more subtle and sophisticated ways than a formalistic legal model would imply. Standing on the shoulders of legal-sociological scholars who explored the interaction between formal and informal order systems,<sup>82</sup> legal theorists were able to draw an impressively more layered and differentiated picture of “contracts in action.”<sup>83</sup>

These evolutionary steps are important to keep in mind today when we learn that a new breed of “social norms theorists” harbor deep scepticism vis-à-vis allegedly incompetent or overzealous judges who adjudicate complex contractual arrangements.<sup>84</sup> In fact, serious attempts to make sense of the formal/informal regulatory environment, which characterized, shaped, and informed contractual governance, had been undertaken. And such attempts had not only been based on extensive empirical research but also had been carried out with particular scrutiny of the economic dimensions of these regulatory patterns.<sup>85</sup> Research on these fronts resulted in, among other insights, a growing awareness of the layers of contractual bargaining that could not fully be explained by reference to

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Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101 (1997).

78. See Stewart Macaulay, *Elegant Models, Empirical Pictures, and the Complexities of Contract*, 11 LAW & SOC’Y REV. 507 (1977).

79. See Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979).

80. See Sally Falk Moore, *Law and Social Change: The Semi-Autonomous Field as an Appropriate Subject of Study*, 7 LAW & SOC’Y REV. 719 (1973).

81. See Mark Granovetter, *The Strength of Weak Ties*, 78 AM. J. SOC. 1360 (1973).

82. See EUGEN EHRLICH, *FUNDAMENTAL PRINCIPLES OF THE SOCIOLOGY OF LAW* (Russell & Russell 1962) (originally published in German as *GRUNDLEGENG DER SOZIOLOGIE DES RECHTS* in 1913); GEORGES GURVITCH, *SOCIOLOGY OF LAW* (Routledge and Kegan Paul 1947) (originally published in French as *PROBLÈMES DE LA SOCIOLOGIE DU DROIT*).

83. See Stewart Macaulay, *Non-contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). For further discussion, see the landmark casebook by STEWART MACAULAY ET AL., *CONTRACTS: LAW IN ACTION* (1995).

84. See ERIC A. POSNER, *LAW AND SOCIAL NORMS* 156 (2000); Robert E. Scott, *The Death of Contract Law*, 54 U. TORONTO L.J. 369 (2004).

85. See, e.g., David Campbell, *The Incompleteness of our Understanding of the Law and Economics of Relational Contract*, 2004 WIS. L. REV. 645; Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978); Zumbansen, *supra* note 5.

either the (subjective) will of the parties or to an established (objective) purpose dimension of the arrangement. Instead, an economic sociology and empirical legal studies approach taken to the scrutiny of contractual arrangements revealed both long-term<sup>86</sup> as well as organizational<sup>87</sup> dimensions that prompted a fundamental reconsideration of the confines of a contractual agreement.<sup>88</sup> This shift in perspective eventually gave way to an increasingly differentiated understanding of the adaptive and, arguably, constitutionalizing dimensions of contract.<sup>89</sup>

#### IV. THE PROMISES (AND PITFALLS) OF CONTRACT GOVERNANCE

Today, the “materialization of contract law”<sup>90</sup> has a sour ring to it because even stern adepts of consumer protection law have grown aware of the intricacies of judicial engagements with fast-evolving, sensible areas of social organization.<sup>91</sup> In response, contract theorists have begun to turn their curious minds to an even more layered analysis of contractual governance, both with regard to a political critique of power relations<sup>92</sup> and a better understanding of contractual networks.<sup>93</sup>

These developments are crucial elements in the formation of a new regulatory landscape, which can be described neither with reference to the state as sole law-producer nor with reference alone to legal rules

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86. Ian R. Macneil, *Relational Contract: What We Do and What We Do Not Know*, 1985 WIS. L. REV. 483.

87. CONTRACT AND ORGANISATION, *supra* note 20.

88. See, e.g., Margaret Jane Radin, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, in *BOILERPLATE: THE FOUNDATION OF MARKET CONTRACTS* 189 (Omri Ben-Shahar ed., 2007).

89. See Rudolf Wiethölter, *Privatrecht als Gesellschaftstheorie?* [Private Law as Theory of Society?], in *FUNKTIONSWANDEL DER PRIVATRECHTSINSTITUTIONEN* [TRANSFORMATION OF THE FUNCTIONS OF PRIVATE LAW INSTITUTIONS] 645 (Fritz Baur et al. eds., 1974); see also Karl Llewellyn, *What Price Contract? An Essay in Perspective*, 40 YALE L.J. 704 (1930).

90. See KARL RENNER, *THE INSTITUTIONS OF PRIVATE LAW AND THEIR SOCIAL FUNCTIONS* (Agnes Schwarzschild trans., Routledge & Kegan Paul 1949) (1929); MAX WEBER, *ON LAW IN ECONOMY AND SOCIETY* (Max Rheinstein ed., Max Rheinstein & Edward Shils trans., 1967); FRANZ WIEACKER, *PRIVATRECHTSGESCHICHTE DER NEUZEIT UNTER BESONDERER BERÜCKSICHTIGUNG DER DEUTSCHEN ENTWICKLUNG* [A HISTORY OF PRIVATE LAW IN EUROPE WITH PARTICULAR REFERENCE TO GERMANY] (1967).

91. See REINHARD DAMM, *Privatautonomie und Verbraucherschutz, Legalstruktur und Realstruktur von Autonomiekonzepten* [Private Autonomy and Consumer Protection: Legal and Real Structure of Concepts of Autonomy], 50 VERSICHERUNGSRECHT [INSURANCE LAW] 129 (1999).

92. See Roy Kreitner, *Frameworks of Cooperation: Competing, Conflicting, and Joined Interests in Contract and its Surroundings*, 6 THEORETICAL INQUIRIES L. 59 (2005).

93. See Marc Amstutz, *The Constitution of Contractual Networks*, in *NETWORKS: LEGAL ISSUES OF MULTILATERAL CO-OPERATION* 309 (Marc Amstutz & Gunther Teubner eds., 2009); GUNTHER TEUBNER, *NETWORKS AS CONNECTED CONTRACTS* (Hugh Collins ed., 2011); Stefan Grundmann, *Die Dogmatik der Vertragsnetze* [The Legal Dogmatics of Contractual Networks], 207 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS [ARCHIVE OF CIVIL LAW PRACTICE] 718 (2007).

when we attempt to depict present and emerging regulatory structures.<sup>94</sup> It should be against this background and in light of legal scholars' attempts to make sense of the legal-sociological, legal-pluralist, and evolutionary theories, as well as prospects of an emerging transnational normative order<sup>95</sup> that we continue to posit the project of "contract governance"<sup>96</sup> vis-à-vis complementing bodies of theory interested in social ordering. Scholars addressing a confrontation between legal and non-legal approaches to contract governance should be mindful of the questionability of law's boundaries as such—today as in the past. As Holmes said:

It is perfectly proper to regard and study the law simply as a great anthropological document. It is proper to resort to it to discover what ideals of society have been strong enough to reach that final stage of expression, or what have been the changes in dominant ideals from century to century. It is proper to study it as an exercise in the morphology and transformation of human ideas. The study pursued for such ends becomes science in the strictest sense.<sup>97</sup>

Contract governance comes onto the scene with considerable baggage; baggage we need to study closely to unpack the continued prominence that contractarian thinking enjoys in the field of corporate governance. The layered inheritance of contract governance expresses itself in the triple dimension of contract governance itself, which can mean that contracts *govern*, or that we are concerned with the governance *of* contracts, or with the governance of contracts that govern.<sup>98</sup> Traditional law and economics scholars would likely embrace the governing function of contracts, while progressive lawyers interested in the materialization of

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94. Karl-Heinz Ladeur, *Towards a Legal Theory of Supranationality – The Viability of the Network Concept*, 3 EUR. L.J. 33 (1997). For a discussion of transnational private law, see GRAF-PETER CALLIESS & PEER ZUMBANSEN, *ROUGH CONSENSUS AND RUNNING CODE: A THEORY OF TRANSNATIONAL PRIVATE LAW* (2010, Paperback 2012).

95. E.g., Ross Cranston, *Theorizing Transnational Commercial Law*, 42 TEX. INT'L L.J. 597 (2007); Clive M. Schmitthoff, *International Business Law: A New Law Merchant*, 2 CURRENT L. & SOC. PROBLEMS 129 (1961); see also Wolfgang Kerber, *Transnational Commercial Law, Multi-level Legal Systems and Evolutionary Economics*, in LAW, ECONOMICS AND EVOLUTIONARY THEORY, *supra* note 68, at 297; Roger Cotterrell, *Spectres of Transnationalism: Changing Terrains of Sociology of Law*, 36 J.L. & SOC'Y 481 (2009); Cotterrell, *What is Transnational Law?*, 37 L. & Soc. Inquiry 500 (2012) [with an extensive discussion of CALLIESS & ZUMBANSEN, *ROUGH CONSENSUS*, note 94]

96. See Riesenhuber & Möslin, *supra* note 2.

97. HOLMES, *supra* note 49, at 212.

98. This last dimension connects contract governance and contract theory with what administrative, and more particularly, environmental lawyers have learned to address from the perspective of regulatory theory. Here, the focus is in particular on reflexive forms of governmental intervention. See, e.g., Eric W. Orts, *Reflexive Environmental Law*, 89 NW. U. L. REV. 1227 (1995). For additional background, see Power, *supra* note 37.

law<sup>99</sup> would tend to focus on the scope of adjudication and judge-made contract law, captured in the governance *of* contracts.<sup>100</sup> Contract governance, understood as a conceptual framework, is an ingenious proposition as an intellectual undertaking and as a research enterprise because it naturally captures both of these dimensions. Because of this capture it is possible to see the inside and the outside of contract governance, which illustrates the complex assumptions that go into the project of “contract governance,” as currently pursued, from the start and explains its promise for a continued depiction of the corporation as a contractual structure. But what has forcefully been shown in the interpretation of the business corporation as a nexus of contracts<sup>101</sup> can just as aptly be applied to the idea of contract governance itself. In both corporate governance and in contract governance, the construction of a complex governance architecture on contract as a self-explanatory and auto-legitimizing principle detaches the contract from its legal-regulatory context by associating it with a sphere distinct from the state and regulatory “intervention.” Such an un-ironic rendering of contract governance understood as governance *by* contract “invisibilizes” the “basis of contract”<sup>102</sup> and hereby continues to ignore the scathing critique offered by Holmes in 1905.<sup>103</sup>

This isolating depiction of contract governance as autonomous from other, allegedly state-based forms of lawmaking and regulatory governance repeats what a number of law and economics scholars have been arguing regarding the autonomy of so-called “social norms.” Scholars identify and herald social norms as the glue of highly differentiated, modern market societies whose complexity renders any attempt by the state’s regulatory apparatus and the judiciary futile.<sup>104</sup>

There is, certainly, another reading of the idea of contract governance that depicts it as a comprehensive societal ordering framework.<sup>105</sup> This reading would hope to undo the “discovery of social norms by law and economics” scholars<sup>106</sup> in order to appreciate the concept of contractual governance as part of a comprehensive theory of contract in a liberal

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99. RENNER, *supra* note 90.

100. John N. Adams & Roger Brownsword, *The Ideologies of Contract*, 7 J. LEGAL STUD. 205, 213 (1987).

101. See William W. Bratton, *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989).

102. See Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933).

103. See *Lochner v. New York*, 198 U.S. 45 (1905).

104. See POSNER, *supra* note 84.

105. See Hugh Collins, *The Voice of the Community in Private Law Discourse*, 3 EUR. L.J. 407 (1997); Zumbansen, *supra* note 5.

106. Robert C. Ellickson, *Law and Economics Discovers Social Norms*, 27 J. LEGAL STUD. 537 (1998).

society.<sup>107</sup> Pondering the embeddedness of contract governance in a framework of both institutional and normative reference points ensures that the connection between society and the practice (and theory) of contracting is never left out of sight. That connection is severed when one plays contract governance off against the governance of contract, as is done by social norms theorists and proponents of a neo-formalist approach to contract law.<sup>108</sup> In contrast, the genius of contract governance has always been the recognition that these two dimensions cannot be separated in a way that one would potentially trump the other. To do so would render absurd the fact that contracting is part of societal interaction. To recognize contractual governance (as governance through contract) as part of society, however, connects the theory of contract governance with the theory of society. And the latter is far too complex to be captured in the scrutiny of this or that instance, where courts wandered into the judicial resolution of complex contractual relationships.

Contract governance cannot be reduced to a theory of social norms independent from the theory of society in which it is embedded. This theory, however, is not fully accessible for the law itself, as it has its own legal rhymes and reasons. But the differentiation of the legal system occurs as the law reacts to the world over time. In doing so, it receives impulses from economics, politics, and religion that perturbate, impregnate, and challenge the law and its toolkit.

#### V. COMING FULL CIRCLE? THE CORPORATION AND CONTRACT GOVERNANCE

For lawyers, taking on economics—either in the way economists engage with psychology and behavioral sciences or in the way economists continue to push our imagination to better understand the nature of institutions<sup>109</sup> and norms<sup>110</sup>—can be fruitful. The lawyers' task highlights that legal theoretical analysis of corporate governance is a complex enterprise.

The promise lies in connecting social norms theory, new institutional economics, behavioral economics, and evolutionary theory with the law's earlier engagement with sociology<sup>111</sup> and political theory<sup>112</sup> in

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107. COLLINS, *supra* note 5, at 3–4.

108. See Scott, *supra* note 84.

109. See NORTH, *supra* note 66; DOUGLASS C. NORTH, UNDERSTANDING THE PROCESS OF ECONOMIC CHANGE (2005).

110. For a poignant assessment, see David Charny, *Illusions of a Spontaneous Order: "Norms" in Contractual Relationships*, 144 U. PA. L. REV. 1841 (1996).

111. See EMILE DURKHEIM, THE DIVISION OF LABOR IN SOCIETY (W. D. Halls trans., Free Press 1984) (1893); MARCEL MAUSS, THE GIFT (W. D. Halls trans., 1990); WEBER, *supra* note 90.

order to unfold the true potential of a historically evolving interdisciplinary exploration of this area of law and corresponding social, economic, and political theory. Such “connecting” cannot simply mean to build on earlier findings by stacking newer trends of “interdisciplinary” studies (à la ‘law and . . .’) onto new ones.<sup>113</sup> Instead, a connection must take into account the yet-unfulfilled promise of these longstanding endeavors to deconstruct, unpack, and lay bare the unquestioned assumptions and holisms of theories such as (economic) efficiency,<sup>114</sup> market freedom,<sup>115</sup> or theories about “the corporation.”<sup>116</sup> This enterprise could potentially have a further reach but is likely to be complemented by a larger set of challenges arising from the diversity of materials, questions of method, and avenues of conceptualization than we are accustomed to in the ordinary law and economics approach to corporate law.<sup>117</sup>

The remainder of this Article is an attempt to draw on the insights from the preceding discussions pertaining to corporate governance and the emerging research into contract governance. Central to the following undertaking is a revisiting of the scholarship and theory regarding “relational contracting.” In order to assess whether and to what degree relational contract theory might offer helpful insights for an alternative contractualist theory of the firm, it will be necessary to review once more the theoretical underpinnings of the contractualist theory of the firm, which has dominated corporate governance debate over the past decades. In that regard, the first part of the following section will critically explore the individualistic assumptions that inform the dominant theory of the firm. In a second step, it will be necessary to restate the methodological underpinnings of relational contract theory, before engaging with the well-known critiques leveled against that theory.

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112. See Stewart Macaulay, *Private Government*, in LAW AND THE SOCIAL SCIENCES 445 (Leon Lipson & Stanton Wheeler eds., 1986).

113. I am grateful to Amar Bhatia (University of Toronto) for having emphasized this point.

114. See Duncan Kennedy, *Cost-Reduction as Legitimation*, 90 YALE L.J. 1275 (1981).

115. See David Campbell, *Breach of Contract and the Efficiency of Markets*, in THE LEGAL FOUNDATIONS OF FREE MARKETS 140 (Stephen F. Copp ed., 2008); Adams & Brownsword, *supra* note 100, at 208 (questioning the postulate of a non-interventionist role of courts in market dealings).

116. This task is similarly recognized among anthropologists. “[A]n anthropological effort to pluralize, relativize, and contextualize corporate forms geographically and historically should participate in an interdisciplinary analytical framework that is actively engaged with the body of substantive empirical work on corporations carried out in other fields.” Welker, Partridge & Hardin, *supra* note 15, at S6.

117. See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991). For suggestions to widen the hitherto pursued dialogue between economics and corporate law, see Hopt, *supra* note 33, at 1161.

*A. The Conundrum of Agency in Contemporary Contract  
and Corporate Theory*

The caveat in order here originates from the implicitly individualistic assumptions that appear to inform some of the current interest in behavioral economics but that also underlie other law and economics approaches—for example, lawyers’ engagement with game theory.<sup>118</sup> The focus on individual or collective (again seen as divisible into separate actors) behavioral patterns suggests that there is still a widely held belief in the possibility of tracing results back to choices, regardless of how irrational these choices might be. Contrast this assumption with the lessons from the financial crisis.

The crisis illustrates the shortcomings of governance and intervention theories that are oriented around linear cause-effect and responsiveness relations between problem and solution.<sup>119</sup> Indeed, if we consider the current research into the origins and causes of the financial crisis, we find that the analytical regulatory theory toolkits of cause-effect relations as well as market-state distinctions<sup>120</sup> are at odds with the more systemic roots of the crisis. The consequences of this shift in perspective, however, are still far from clear. But what is emerging is a need to seriously reflect on regulation as the basis of recognizing complex systemic boundaries, spheres, and co-dynamics. Then, on the basis that there is a fundamental inability to fully translate rationalities of one system—law, economics, politics, religion, etc.—into another, one would more adequately understand how regulatory approaches that aim to universalize the rationality of one system by imposing them on others are bound to fail.

This can be illustrated by taking the example of law as a social system: “Legal forms encode information about coordination strategies which have proved more or less successful in particular social settings, including the economic domains of the market and the business enterprise.”<sup>121</sup> This does not mean that the economic system is able to either incorporate, let alone understand, this particular approach to the framing

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118. See, e.g., Anne van Aaken, *Effectuating Public International Law Through Market Mechanisms?* 165 J. INSTITUTIONAL & THEORETICAL ECON. 33 (2009). For a critical discussion of lawyers’ usages of game theory, see Simon Deakin, *Legal Evolution: Integrating Economic and Systemic Approaches* (Univ. of Cambridge Faculty of Law Research Paper No. 41/2011, 2011), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1934738](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1934738).

119. See the exchange between Erhard Blankenburg, *The Poverty of Evolutionism: A Critique of Teubner’s Case for ‘Reflexive Law’*, 18 LAW & SOC’Y REV. 273 (1984), and Gunther Teubner, *Autopoiesis in Law and Society: A Rejoinder to Blankenburg*, 18 LAW & SOC’Y REV. 291 (1984).

120. For a refreshing deconstruction, see Rena Steinzor, *The Truth About Regulation in America*, 5 HARV. L. & POL’Y REV. 323 (2011).

121. Deakin, *supra* note 118, at 1.

of coordination strategies within its own reference system, nor that this would work the other way around. Law and economics, as an engagement between both systems, is too often presented as being able to draw on shared concerns about efficiency, costs, externalities, or of course, rights.<sup>122</sup> Surely, however, each means different things to this or that system.<sup>123</sup>

As a result, contract governance offers a welcome opportunity to reach out but also to reach back. This is not novel for lawyers, who are known to be constantly laboring on models of law that are developed in response to what has been perceived as a heightened complexity of society. While this endeavour of formulating legal responses to societal problems is too often understood as one that lies within the competence area of public lawyers, contract lawyers have continued to claim that their field cannot be understood in separation from an encompassing understanding and theorizing of social complexity.<sup>124</sup> The emerging research field of contract governance promises to shed some new light<sup>125</sup> on the interaction and overlap between contractual and organizational governance dynamics by exploring the governance function of contract and corporate law as parallel regulatory paradigms, tightly interwoven in the face of highly volatile markets.<sup>126</sup>

Contract and corporate law need to be understood as being adequately “open” to allow for taking on board the specific contextual particularities that characterize contract governance. The need is particularly acute when the function of contract governance consists of dealing with complexity, as with various forms of risk. The focus on risks that need to be managed by corporate managers—rather than the common interest in conceptualizing management’s or the corporation’s “responsibility”—is of crucial importance in a new assessment of what we should actually understand as directors’ *responsibilities*, on the one hand, and the availability of defenses on the other. But in light of an evolving jurisprudence on business judgment and entire fairness, what would this mean concretely? One way of going forward would be to use the framework and

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122. “But it has to be remembered that the immediate question faced by the courts is *not* what shall be done and by whom but *who* has the legal right to do what.” Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960).

123. See, e.g., Duncan Kennedy, *Law-and-Economics from the Perspective of Critical Legal Studies*, in THE NEW PALGRAVE DICTIONARY, *supra* note 43, at 466–67; Kennedy, *supra* note 114.

124. See, e.g., John P. Esser, *Institutionalizing Industry: The Changing Forms for Contract*, in LAW AND SOCIAL INQUIRY 593 (1996); Campbell, *supra* note 115.

125. See here in particular the contributions to CONTRACT AND ORGANISATION, *supra* note 20.

126. Florian Mösllein, *Contract Governance und Corporate Governance im Zusammenspiel – Lehren aus der globalen Finanzkrise* [Contract Governance and Corporate Governance in Interaction: Lessons from the Global Financial Crisis], 65 JURISTENZEITUNG (JZ) [LAWYERS’ JOURNAL] 72, 78 (2010).



concept of contract governance to reach beyond the oppositional poles that characterize principal-agent relations within the corporation. Whereas contract thinking within the corporation is too often pitted against allegedly undue state intervention, a more differentiated model of contract governance would allow us to take the analysis to the next level. For such a model, it is necessary to return briefly to the well-known tension between classical and relational contracts.

*B. Beyond Public versus Private: The Promise of Relational Contract Theory for a New Theory of the Firm*

Relational contracting depicts complex contractual arrangements over time in order to allow for a more adequate description of the combination of contract, bargain, organization, amendment, and adaptation that characterize numerous contractual business relations today.<sup>127</sup> Far from depicting anything “cosy” or “familial” in those relations,<sup>128</sup> relational contract theory was primarily interested in developing a more adequate rendering of the existing contractual governance practice in multi-polar, time-extended business settings.

The need for providing context for the assumptions and arguments of relational contract theory and social norms theory exists because of the apparent proximity of the two theories. Relational contracting exists in private market contexts and in public-private regulatory and collaboration contexts; it is the transformation of the surrounding regulatory landscape toward further decentralization and proceduralization that prompts a renewed interest in exploring the “public dimension” of such contractual arrangements.<sup>129</sup> The qualification of a contract as “public” in infrastructure maintenance or service delivery, which was formerly governed and carried out under the auspices of the state, is less contentious than a depiction of long-term contractual arrangements with built-in or associated amendment and adaptation capabilities as public. It is more contentious because of the difference in context and the consequences of attributing “public” qualities to a contractual arrangement commonly perceived as being of a private nature. The corporation springs to mind as the definitive example—at least from the mainstream perspective. To qualify contractual relations inside or outside of the corporation as public

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127. See Macneil, *supra* notes 85 & 86.

128. But see Gunther Teubner, *Contracting Worlds: The Many Autonomies of Private Law*, 9 SOC. & LEGAL STUD. 399–417 (2000), and the response by Ian R. Macneil, *Contracting Worlds and Essential Contract Theory*, 9 SOC. & LEGAL STUD. 431 (2000).

129. See, e.g., Alfred C. Aman, Jr., *An Administrative Law Perspective on Government Social Service Contracts: Outsourcing Prison Health Care in New York City*, 14 IND. J. GLOBAL LEGAL STUD. 301 (2007).

and to base such a qualification on assertions of particular dimensions of responsibility or accountability short-circuits the attempt to unpack the concept of relational contract within the corporation by reformulating the nature of the firm through a comprehensive theory of corporate social responsibility.

Does this thought experiment already spell the end for the attempt to bring relational contract thinking into the ambit of the corporation? Is this equal to the touching of the third rail? A possible solution might be found if we returned to the initial impetus that led us to undertake a parallel study of contract governance and corporate governance. A driving idea at the basis of this project is the concern with the conceptual shortcomings of the dominant “theories of the firm.” Referenced as either shareholder or stakeholder theories respectively, we regularly find the construction of two diametrically opposed explanatory frameworks, neither of which is sufficiently sophisticated to provide a satisfying answer to most of the conflicts arising inside and outside of a corporation. We find an under-theorized concept of contract governance, a concept that basically operates with the most rudimentary assertion of contractual bargaining. Conversely, we find assertions of an organization, holistic in nature, implausibly overburdened with just about any social, political, or public concern one would wish to place on the shoulders of the next best “powerful company.”

The lesson to be learned from relational contracting is in fact within reach. Rather than merely pitting long-term contracting and adaptation arrangements against one-off exchange contracts, it would seem much more promising to return to the idea of relational contracting from a methodological perspective. This means that relational contracting is to be understood as a governance framework (albeit with loopholes and reasons for contestation)<sup>130</sup> for complex interactional arrangements, but at the same time, relational contracting, perhaps better than canonical corporate law doctrine, allows us to incorporate contextual evidence into our governance of the contracts at issue. The example of fiduciary duties illustrates this point. When we (used to) force reified conceptions of the purpose of the corporation into the demarcations of a duty of loyalty,<sup>131</sup> the only viable response is a choice between regulation and deference to

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130. See, e.g., Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847 (2000); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006).

131. See, e.g., EASTERBROOK & FISCHER, *supra* note 117, at 90–108. But see BERLE, *supra* note 11, at 61–115; FREUND, *supra* note 19, at 35–36 (emphasizing the intertwined public and private natures of the business associations and the related problems of theorizing the firm’s responsibility and the subsequent sections).

business judgment.<sup>132</sup> When, however, we stress the idea of the corporation as a web of interlocking and overlapping contracts beyond the basic assertion of a “nexus of contracts,” it becomes possible to perceive of the now more fully visible contractual arrangements throughout and beyond the corporation as representations of a highly differentiated governance network.

The difference between this contractual-network concept and the otherwise dominant, if still slightly incoherent model of the contractual corporation,<sup>133</sup> is that this conception forces us to more adequately consider the context in which the contractual arrangement is situated. This context is characterized by a deep and fundamental transformation of public accountability and sovereign stature regarding the creation, delivery, and maintenance of services that are widely perceived as pertaining to the common good; in other words, the large-scale transformation, if not the erosion, of the (Western) welfare state.<sup>134</sup> This has important consequences for our engagement with the corporation as a target and site of regulatory governance. As it becomes increasingly difficult to offset the allegedly private nature of the corporation against the “public” nature of regulation and intervention, an implied understanding of allegedly public or private dimensions of the contracts entered into by different parties inside and outside of the corporation cannot govern the opposition of different interests within the corporation. Instead, a different set of categorizations must ensue, which must guide the interpretation of contractual rights. While there is not sufficient space here to elaborate this more fully,<sup>135</sup> the broader scope of such categories can already be sketched.

The crucial element in the recontractualization of the corporation lies in the new understanding of the contractual relations between different “stakeholders” in and around the corporation. From the proposed perspective, contracts cannot simply be understood as instantiations of rights and duties creating relations between different stakeholders. Instead, the perspective moves away from an individualistic perception of the endpoints of the contractual relations toward a more systematic understanding. Whereas now, the endpoints of all contracts within the corporation are identifiable with particular positions, carriers of interests, and different degrees of power, an alternative understanding would insist on expanding the scope of this identification so that the context of the as-

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132. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

133. See William W. Bratton, *Welfare, Dialectic, and Mediation in Corporate Law*, 2 BERKELEY BUS. L.J. 59 (2005).

134. See *THE NEW POLITICS OF THE WELFARE STATE* (Paul Pierson ed., 2001).

135. For earlier considerations, see Peer Zumbansen, *The New Embeddedness of the Corporation: Corporate Social Responsibility in the Knowledge Society*, in *THE EMBEDDED FIRM*, *supra* note 17, at 119.

sumed, defended, and mobilized bargaining positions can be considered. This would lead to an enriched understanding of the different contracting parties. The enrichment would go not only significantly beyond diametrical opposition between owners and managers but also beyond that between investors and employees. If the identification of a contract's endpoint allowed for an illumination of the larger context and framework within which someone entered into and assumed a particular contracting position, it would become possible to take the contract's, and with that the corporation's, context and environment into consideration. The expanded consideration can then be incorporated in identifying who is at the respective ends of contractual relations within the corporation.

*C. The Many Bases of Contracts*<sup>136</sup>

One could argue that this might result in a similar overburdening of contractual relations that already characterized the theoretical policy proposals put forward by first and second generation consumer protection law scholars.<sup>137</sup> The difference between both approaches, however, is already the different "moment in time." Today's attempts to develop a protective framework of consumer rights can build on a far more acknowledged policy framework supporting its underlying cause,<sup>138</sup> but consumer law advocates now operate in a far more decentralized and volatile institutional and normative environment.<sup>139</sup> This constellation suggests some structural similarity between the conditions of private contracting in the area of consumer goods, as well as (formerly public) services and provisions on a global scale and intra-corporate contracting. The interests represented by those at the endpoints of the respective contracts are different today than they used to be. With a fundamental shift in the public and private provision of basic needs security, social insurance, and old age security guarantees, the association of contracts with the "market" or the "state" in order to delineate scope and extension of rights and responsibilities is no longer an option. Seeing relations within the corporation through a contractual lens allows for a better appreciation of the context out of which a contract arose.

This empowerment, however, is not only associated with traditionally weak parties in the corporate governance regime such as employees,

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136. Reverential apologies to Morris R. Cohen, *supra* note 102.

137. For a differentiated treatment, see Iain Ramsay, *Consumer Law and the Search for Empowerment*, 19 CAN. BUS. L.J. 397 (1991).

138. See, e.g., Geraint Howells & Thomas Wilhelmsson, *EC Consumer Law: Has it Come of Age?*, 28 EUR. L. REV. 370 (2003).

139. See Daniela Caruso, *Private Law and State-Making in the Age of Globalization*, 39 N.Y.U. J. INT'L L. & POL. 1 (2006); Ugo Mattei & Fernanda Nicola, *A "Social Dimension" in European Private Law? The Call for Setting a Progressive Agenda*, 41 NEW ENG. L. REV. 1 (2006).

creditors, the environment, and society at large, but instead, this empowerment is also felt at all endpoints of the contractual-network structure. Directors would hereby be given a far greater opportunity to have their position within the firm recognized and scrutinized well beyond the routine assertions of a director discharging the duty of loyalty.

There are two reasons, then, why we should not so directly embrace the idea of empowerment. The first reason follows from an appreciation of the fallacies of romanticizing private relations without taking into account the power relations that inform and shape the levels of freedom available to the different participants in a private regulatory regime.<sup>140</sup> While consumer protection law went some way in indicating regulatory responses to the problems of bargaining asymmetry, we now find ourselves often confronted with a much more complex, multi-polar contractual setting, which is not as easily amenable to a “weak” versus “strong” party assessment as would perhaps have been the case in differently structured contractual arrangements. Second, comparison with earlier forms of consumer law is inappropriate because of the altered regulatory landscape. Whereas before the law around consumer contracts had to keep an eye on both national and (some) international legislation, as well as case law, today’s consumer law is an extremely fluid mixed body of norms. Some of these norms emerged from traditional state-based sources, while others do not stem from traditional lawmakers. They both emerge from and contribute to the evolution of a volatile, transnational regulatory regime.<sup>141</sup> The same can be said for corporate law, which has long been a fundamentally transnational regulatory field; the hybrid nature of actors, norms, and processes makes corporate law a very promising area for legal-sociological and legal-pluralist analysis.

Consumer protection law has illustrated the political dimensions of negotiating the adequate relationship between private autonomy and state intervention just as powerfully as the debate around the convergence or divergence of corporate governance models. Against this background, politics still very clearly matter in the continuously unfolding research agenda around contract and corporate governance, but the term “politics” on its own hardly contributes to a further refinement of the fields as pertinent governance fields. What is “political” about contract governance, just as it is about corporate governance or about the regulation of labor markets, is anything but an identifiable selection of different interests or even stakeholders. The fallacy of methodological individualism turns out to trigger highly undesirable consequences, as it falls dramatically short

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140. See Charny, *supra* note 110.

141. See CALLIESS & ZUMBANSEN, *supra* note 94, at ch. 3; Graf-Peter Calliess, *The Making of Transnational Contract Law*, 14 IND. J. GLOBAL LEGAL STUD. 469 (2007).

of capturing the complexity that ties contracts, corporations, and labor markets together. To study this complex landscape, we must develop a methodology that appreciates the fundamental differences in systems' description and construction of the world in order to imagine a non-unifying, pluralist approach to making sense of governance, regulation, and of the "and" in law and economics.

It follows that an enhanced interdisciplinary study of the non-contractual "foundations" of contracting cannot stop at the sociological analysis of *how* and *between whom* promises are made and how they are implemented, enforced, and institutionalized. As we have seen, we must take into account as relevant the individual and collective disposition of market actors and the larger patterns and mechanisms of information transmission, such as those that lead to changes in stock markets.<sup>142</sup> The cautionary tale here, particularly for the legal and economic scholars who have recently begun to embrace "social norms" and institutional economics as the foundation of a social theory of regulation, is that to focus on just this side of market behavior might too easily provide a platform for a one-sided and de-contextual focus on "what people do." One risk with such a behavioral analysis, disembedded from the larger societal context in which human behavior occurs, is that we cut the ties between longstanding sociological research into societal change and our present interest in contracts as prime modes of governance. Further, we risk severely underestimating the nature of the norms we are referring to under the umbrella of "social norms."

Building on legal sociology and legal pluralism on the one hand, and on new institutional economics on the other, will go some way toward a more differentiated understanding of norms in the evolving complex regulatory landscape that characterizes the interaction of public, private, state-originating, and non-state informal norms today. But even that approach would have to more seriously consider different alternative types and shapes of norms: cultural, symbolic, or in other ways non-legal. A more suitable methodological approach would attempt to see beyond and between individual motivations, beliefs, or rationales that drive behavior in order to overcome the focus either on market versus non-market spheres or the breaking up of a complex environment into different interests.

To reiterate the context in which our current investigations are embedded, if complexity is one (if not the crucial) determinative challenge

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142. See, e.g., GEORGE A. AKERLOF & ROBERT J. SHILLER, *ANIMAL SPIRITS: HOW HUMAN PSYCHOLOGY DRIVES THE ECONOMY, AND WHY IT MATTERS FOR GLOBAL CAPITALISM* (2009) (harking back, of course, to John Maynard Keynes's chapter 12 in *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 147, 161 (1965)).

facing any attempt at formulating regulatory responses to situations of crisis (such as those sought in response to the current financial crisis, but not limited to this moment in time), then it is important to acknowledge the core trait of complexity and recognize that it cannot be broken down into or explained through its constituent parts.<sup>143</sup> Rather than trying to devise a meta-code oriented around a particular central or dominating goal or value, regulation will have to take into account the need to devise a process that appreciates the different functional rationalities at work within a particular regulatory problem. Such an approach would include a fundamental shift from normative to cognitive expectations in the structure and the understanding of regulatory processes.<sup>144</sup> While this approach was made with particular reference to the challenges facing legal theory in the context of a fragmented global legal order,<sup>145</sup> it forcefully applies to the current conundrum of financial regulation as much as it does to the fields of contract governance<sup>146</sup> and corporate governance. The latter areas constitute formidable examples of complex regulatory arenas in that they each defy categorizations along traditional forms of political versus non-political, state versus non-state, and public versus private regulation.

Both areas are public and private at the same time—and more. In addition, they are neither national nor international, neither formal nor informal. Our distinctions can go only so far in illuminating the component structure of financial regulation or contract governance. The exhaustion of these distinctions illustrates the inadequacy of trying to associate governance processes with structures of either “regulation” or “self-regulation.” This association would make sense only if the boundaries demarcated self-standing structures of norm generation and implementation. That is not the case; we base our distinction in the end on the appreciation of a particular level of deference or “autonomy.” In the case of regulation, this ordinarily depicts the state as having the choice to intervene or not to intervene. By contrast, “self-regulation” depicts actors—individual or institutional—as exercising norm-generating authority on an autonomous basis, that is, free from regulation as intervention. The

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143. See Deakin, *supra* note 118, at 11.

144. For more background, see Marc Amstutz, *Globalising Speenhamland: On the Transnational Metamorphosis of Corporate Social Responsibility*, in KARL POLANYI, *GLOBALISATION, AND THE POTENTIAL OF LAW IN TRANSNATIONAL MARKETS* 359, 373–74 (Christian Joerges & Josef Falke eds., 2011).

145. See *id.*; see also Gunther Teubner, ‘Global Bukowina’: *Legal Pluralism in the World Society*, *GLOBAL LAW WITHOUT A STATE* 3 (Gunther Teubner ed., 1996).

146. See Amstutz, *supra* note 144; Teubner, *supra* note 145.

fragmentary nature of this depiction is not new,<sup>147</sup> but beyond the clarification of the rights basis of the exercise of authority, there is the problem of over-individualizing who in fact is regulating or self-regulating. The current attempts to push regulatory theory toward a framework that can incorporate systemic linkages<sup>148</sup> underline the importance to move beyond “interests” and “stakeholders”<sup>149</sup> to a more differentiated system of “affectedness.”<sup>150</sup> This move represents one of the keys to thinking about regulation and governance.

The correlation between an interest in “affectedness” among constitutionalists and democracy theorists cannot render us blind to the “use of knowledge in society.” As forcefully demarcated by Friedrich Hayek, the analytical emphasis has to be on the adequate locus and the level of (self-) regulation.<sup>151</sup> This connection between grass-roots perspectives on political legitimacy and the economists’ interest in identifying the best level of rule generation is important, as it allows a more encompassing appreciation of the regulatory challenges arising in a landscape that displays increasingly prominent elements of deterritorialized, decentralized, and nontraditional forms of legislation.<sup>152</sup> Because an economic assessment of the merits of decentralization, as well as regulatory competition over harmonization,<sup>153</sup> cannot drill deeply enough into issues of represen-

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147. See Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923); Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L.Q. 8 (1927).

148. See Marc Amstutz, *Eroding Boundaries: On Financial Crisis and an Evolutionary Concept of Regulatory Reform*, in THE FINANCIAL CRISIS IN CONSTITUTIONAL PERSPECTIVE: THE DARK SIDE OF FUNCTIONAL DIFFERENTIATION 223 (Poul F. Kjaer et al. eds., 2011).

149. See also Peer Zumbansen & Simon Archer, *The BCE Decision: Reflections on the Firm as a Contractual Organization* (CLPE Research Paper No. 17/2008 2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1160094](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1160094).

150. See the important work by Cotterrell, *supra* note 95, and David Held, *Democratic Accountability and Political Effectiveness from a Cosmopolitan Perspective*, 39 GOV'T & OPPOSITION 364 (2004). The theme of “affectedness” is certainly a key notion in constitutionalism studies. See, e.g., JAMES TULLY, *STRANGE MULTIPLICITY: CONSTITUTIONALISM IN AN AGE OF DIVERSITY* (1995).

151. “[D]ecisions must be left to the people who are familiar with those circumstances, who know directly of the relevant changes and of the resources immediately available to them.” Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 524 (1945); see also ERIN A. O'HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* (2009) (applying such thinking in legal rule-making); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

152. See TIM BÜTHE & WALTER MATTLI, *THE NEW GLOBAL RULERS: THE PRIVATIZATION OF REGULATION IN THE WORLD ECONOMY* (2011); Larry Catá Backer, *Private Actors and Public Governance Beyond the State: The Multinational Corporation, the Financial Stability Board, and the Global Governance Order*, 18 IND. J. GLOBAL LEGAL STUD. 751 (2011).

153. See Konstantine G. Gatsios & Peter H. Holmes, *Regulatory Competition*, in THE NEW PALGRAVE DICTIONARY, *supra* note 43, at 271. But see Paul B. Stephan, *Regulatory Cooperation and Competition: The Search for Virtue*, in TRANSATLANTIC REGULATORY COOPERATION: LEGAL PROBLEMS AND POLITICAL PROSPECTS 167 (George A. Bermann et al. eds., 2000); Jonathan R.



tation and legitimacy, it is crucial to take noneconomic considerations into view that approach the issue through the lens of pluralism and norm theory.<sup>154</sup>

## VI. CONCLUSION

So, what lessons are we able to draw at this point? The “awesome social invention”<sup>155</sup> of the large publicly held corporation continues to be a focal point of intensive analysis. The study of the corporation necessitates a reflection on the methods and theories with which we approach this undertaking. The reflection on corporate governance, contract governance, and the interdisciplinary nature of corporate law is an important prerequisite for an enhanced understanding of the nature of the corporation.

But the continuing investigations into the “nature” of the corporation show that contractual and organizational models of the corporation still inform our thinking about a theory of the firm. The same is true for attempts to carve out the definitive private or public nature of the firm. Such attempts say more about the concurring efforts in making sense of a globalizing, complex society, a society that in the West has been described for some time through the demarcations of public and private spaces, referring to the state on one hand, and to the market on the other. The treacherous nature of such distinctions is well known by now and rejected by hardly anyone. What is at stake around the endless rounds of contestation and resurrection of these distinctions is what really matters.

Contracts have been crucial instruments and *fora* of societal governance for a long time. But that has never meant, nor should it today, that they can be studied in isolation from the context in which they perform regulatory functions. Parties do not simply enter into agreements outside or “in the shadow of the law” because they deem it efficient. The “turn to contract” occurs in the context of a richly structured field of public and private intersecting modes of governance. To celebrate either contract or social norms as the (late) expressions of economic liberalism will give little guidance to the questions we face today. Economic governance must correctly be understood as a call to arms—not *against* the alleged interventionist fervor of zealous governments or activist judges, but rather for the building of a comprehensive, interdisciplinary theory of (market) governance today.

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Macey, *Regulatory Globalization as a Response to Regulatory Competition*, 52 EMORY L.J. 1353 (2003).

154. See, e.g., Moore, *supra* note 80; and Sally Engle Merry, *Anthropology, Law, and Transnational Processes*, 21 ANN. REV. ANTHROPOLOGY 357 (1992).

155. Jensen & Meckling, *supra* note 1, at 357.

